(9)

No. 95-1181

In the Supreme Court of the United States

OCTOBER TERM, 1995

WILLIAM C. DUNN & DELTA CONSULTANTS, INC.,
PETITIONERS

v.

COMMODITY FUTURES TRADING COMMISSION, ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE COMMODITY FUTURES TRADING COMMISSION

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QUESTION PRESENTED

Whether the "Treasury Amendment" to the Commodity Exchange Act (CEA), 7 U.S.C. 1 *et seq.*, which provides in pertinent part that "[n]othing in this chapter shall be deemed to govern or in any way be applicable to transactions in foreign currency * * * unless such transactions involve the sale thereof for future delivery conducted on a board of trade," 7 U.S.C. 2(ii), excludes off-exchange foreign currency options from CEA regulation.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-7a) is reported at 58 F.3d 50. The order and memorandum of the district court (Pet. App. 1b-6b) are unreported.

JURISDICTION

The judgment of the court of appeals was entered on June 23, 1995. A petition for rehearing was denied on August 4, 1995 (Pet. App. 1c-2c). On December 12, 1995, Justice Ginsburg extended the time for filing a petition for a writ of certiorari to and including January 23, 1996. The petition was

filed on that date, and it was granted on May 28, 1996. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTORY PROVISION INVOLVED

The "Treasury Amendment" to the Commodity Exchange Act (CEA), 7 U.S.C. 1 *et seq.*, provides as follows:

> Nothing in this chapter shall be deemed to govern or in any way be applicable to transactions in foreign currency, security warrants, security rights, resales of installment loan contracts, repurchase options, government securities, or mortgages and mortgage purchase commitments, unless such transactions involve the sale thereof for future delivery conducted on a board of trade.

7 U.S.C. 2(ii).

7 U.S.C. 2 in its entirety, as well as 7 U.S.C. 5 and 6c, are reproduced at App. A, *infra*, 1a-9a.

STATEMENT

The Commodity Futures Trading Commission (CFTC) brought suit in the United States District Court for the Southern District of New York against petitioners William C. Dunn and Delta Consultants, Inc. (as well as two additional corporate defendants), charging them with fraud in connection with commodity option transactions, in violation of the Commodity Exchange Act (CEA), 7 U.S.C. 1 *et seq.*, and associated regulations. See 7 U.S.C. 6c(b); 17 C.F.R. 32.9. The district court granted the CFTC's motion for the appointment of a temporary receiver, Pet. App. 1b-6b, and petitioners sought apellate review

under 28 U.S.C. 1292(a)(2). The court of appeals affirmed the district court's order, rejecting petitioners' argument that the Treasury Amendment to the CEA, 7 U.S.C. 2(ii), deprives the CFTC of jurisdiction over transactions in foreign currency options that are not conducted on an organized exchange. Pet. App. 1a-7a.

A. The History Of Commodity Futures And Options Regulation

This Court has recounted the history of commodity futures regulation in *Merrill Lynch, Pierce, Fenner & Smith, Inc.* v. *Curran*, 456 U.S. 353, 355-367 (1982). The concept of a "commodity future" originated in the needs of farmers and their customers to fix the price of agricultural products before harvest and delivery. Those parties found it useful to engage in the sale of a commodity before it was ready for market by agreeing to terms for future delivery at a specified price. See 456 U.S. at 357-358. The growth of that practice led to the organization of commodity exchanges, which employ standard contracts and rules for trading. The exchanges not only provide price discovery and hedging functions for commodity producers and processors, but they also provide speculative opportunities for investors. *Id.* at 359-360. See also S. Rep. No. 1131, 93d Cong., 2d Sess. 11-14 (1974).

1. *Initial regulation of futures and options trading.* In 1848, when the Chicago Board of Trade was founded as the first American commodity exchange, traders engaged primarily in the purchase and sale of "futures" contracts, which obligate the seller to deliver a commodity, and the buyer to pay for it, on a specified future date. See Jerry W. Markham, *The*

History of Commodity Futures Trading and Its Regulation 4 (1987). By 1865, commodities traders were also engaged in the purchase and sale of "options" contracts (also known as "privileges," "indemnities," "puts," and "calls"), which granted the option holder the unilateral temporary right, but not the obligation, to purchase or sell a commodity at a specified price. *Id.* at 8-9. Although futures and options bear important similarities, they have always been recognized as distinctly different transactions, both as a matter of law and as a matter of practical consequence. See, *e.g.*, 1 Timothy J. Snider, *Regulation of the Commodities Futures and Options Markets* §§ 7.01-7.02, 10.11-10.13 (2d ed. 1995); Robert C. Lower, *The Regulation of Commodity Options*, 1978 Duke L.J. 1095, 1096 nn.2 & 3; see also pages 37-39, *infra*.

During the late 19th and early 20th centuries, farmers and other members of the general public came to question the integrity of the commodity markets. They complained that speculation in commodity futures and options resulted in devastating price swings, particularly when exchange participants attempted to "corner" the market in particular commodities. See Markham, *supra*, at 5-7, 10-11. They also criticized certain off-exchange practices, including the operation of "bucket shops," which enticed individuals to place bets on commodity price movements. *Id.* at 9-10, 11. Proponents of reform frequently identified options trading as a particular source of abuse. Many farmers and grain dealers considered options as simply gambling contracts that were unnecessary to the functioning of the marketplace. 1 Snider, *supra*, at § 7.03; Markham, *supra*, at 8-9; Lower, *supra*, 1978 Duke L.J. at 1097-1101.

The outbreak of World War I led to rampant commodity speculation and ultimately prompted Congress to enact the Futures Trading Act of 1921, ch. 86, 42 Stat. 187. See Markham, *supra*, at 10-12. Congress attempted to curb price manipulation and bucketing by imposing a prohibitive tax on grain futures unless they were traded on government licensed boards of trade, known as "contract market[s]," that met prescribed governmental standards. § 4, 42 Stat. 187. In addition, Congress proposed a prohibitive tax on *all* grain options. § 3, 42 Stat. 187. That provision reflected the sentiment, expressed in congressional hearings, that options were simply "gambling" transactions. See, *e.g.*, *Future Trading In Grain: Hearings on H.R. 5676 Before the Senate Comm. on Agriculture and Forestry*, 67th Cong., 1st Sess. 60-63, 180 (1921); see also *id.* at 84 (noting that the "national trades" favored prohibiting privileges).

This Court ruled that the provisions of the Futures Act of 1921 that placed a tax on futures transactions conducted outside of a contract market were an unconstitutional exercise of the taxing power. See *Hill* v. *Wallace*, 259 U.S. 44 (1922). In response, Congress enacted the Grain Futures Act of 1922, ch. 369, 42 Stat. 998, which relied on the Commerce Clause to prohibit futures transactions outside of a licensed contract market. The Court rejected a challenge to the constitutionality of that legislation, *Board of Trade of Chicago* v. *Olsen*, 262 U.S. 1 (1923), and the federal government began to conduct regulatory oversight of the futures markets, Markham, *supra*, at 14-21. Questions remained, however, over the constitutionality of the surviving provisions of the Futures Trading Act of 1921, not at issue in *Hill*, that placed a prohibitory tax on options. See 259 U.S. at

71. The Court eventually invalidated the options tax. *Trusler* v. *Crooks*, 269 U.S. 475 (1926). As a result, trading in options resumed. See Markham, *supra*, at 20; Lower, *supra*, 1978 Duke L.J. at 1100-1101.

2. *The Commodity Exchange Act of 1936.* Following the stock market crash of 1929, the market for wheat and other grains began to weaken. In 1932, speculative trading led to a calamitous collapse in wheat prices, and President Roosevelt called for expanded regulatory controls over the commodity markets. See 1 Snider, *supra*, at § 7.03; Markam, *supra*, at 22-25; Lower, *supra*, 1978 Duke L.J. at 1101. In response, Congress enacted the Commodity Exchange Act of 1936 (CEA), ch. 545, 49 Stat. 1491. Congress adopted the CEA to "insure fair practice and honest dealing on the commodity exchanges, and to provide a measure of control over those forms of speculative activity which too often demoralize the markets to the injury of producers and consumers and the exchanges themselves." H.R. Rep. No. 421, 74th Cong., 1st Sess. 1 (1935).

Congress enacted the CEA as an amended version of the Grain Futures Act. See § 1, 49 Stat. 1491. Congress defined the term "commodity" to include specifically enumerated agricultural products, including grains, butter, eggs, potatoes, rice, and cotton, see §§ 2-3, 49 Stat. 1491, and it continued to allow trading of futures contracts in those commodities in the controlled environment of a federally-designated "contract market," see §§ 4-5, 49 Stat. 1492. Congress subjected those markets, however, to more exacting registration and regulatory requirements, which were administered by the Department of Agriculture's Commodity Exchange Authority. Congress also prohibited specific trading practices that were

believed to contribute to excessive speculation, price instability, market manipulation, or fraud. See §§ 4-9, 49 Stat. 1492-1501; see generally Markham, *supra*, at 27-34.

Congress specifically outlawed trading in options. See § 5, 49 Stat. 1494 (adding Section 4c). Many persons, including Members of Congress, believed that options trading encouraged inappropriate speculation and played a significant role in the wheat market's collapse. See Lower, *supra*, 1978 Duke L.J. at 1101 & n.23; see also, *e.g.*, 78 Cong. Rec. 10,449 (1934) (Rep. Gilchrist) (denouncing options as "purely gambling transactions" that "prevent the producer from getting an honest price"). In the face of concerns that options "lent themselves to cheating or fraudulent practices," 80 Cong. Rec. 6162 (1936), Congress enacted an outright ban on the trading of options in the enumerated commodities. That ban effectively brought an end to commodity option trading in the United States for the next 35 years. See 1 Snider, *supra*, at § 7.03; Lower, *supra*, 1978 Duke L.J. at 1098, 1101-1102.

3. *The Commodity Futures Trading Commission Act of 1974.* During the decades following the enactment of the CEA, the commodity markets grew in both size and complexity as world-wide trade developed in new and previously unregulated commodities. See, *e.g.*, Markham, *supra*, at 35-59. Congress responded to the evolution in the commodity markets in 1968 by extending the coverage of the CEA. See Act of Feb. 19, 1968, Pub. L. No. 90-258, 82 Stat. 26. But six years later, Congress concluded that more significant changes were needed, and it enacted the Commodity Futures Trading Commission Act of 1974

(CFTC Act), Pub. L. No. 93-463, 88 Stat. 1389. See S. Rep. No. 1131, *supra*, at 18-19. The CFTC Act comprehensively overhauled and expanded the CEA, which is codified as amended at 7 U.S.C. 1 *et seq.* The CFTC Act also created the CFTC as a new federal agency devoted to commodity futures and options regulation. See generally Markham, *supra*, at 60-72. Two general considerations of the CFTC Act are particularly pertinent to this case.

First, Congress greatly expanded the scope of federal commodity regulation. Since the enactment of the CEA in 1936, world markets had developed for new commodities, such as coffee, sugar, and precious metals, which were not regulated under the CEA. In the face of that development, Congress redefined the term "commodity" to include not only previously enumerated commodities, but also virtually "all other goods and articles * * * and all services, rights, and interests in which contracts for future delivery are presently or in the future dealt in." 7 U.S.C. 1a(3). Congress also gave the CFTC correspondingly broad regulatory power over trading in those commodities. Subject to certain important exceptions (including the Treasury Amendment, discussed below), Congress gave the CFTC "exclusive jurisdiction" with respect to "accounts, agreements * * *, and transactions involving contracts of sale of a commodity for future delivery." 7 U.S.C. 2(i). See generally S. Rep. No. 1131, *supra*, at 23-24, 31; H.R. Conf. Rep. No. 1383, 93d Cong., 2d Sess. 35-36 (1974).

Second, Congress retained the CEA's ban on trading of options involving the previously-regulated agricultural commodities, 7 U.S.C. 6c(a)(B) (1976), but it left open the possibility of an options market in

the new commodities. Congress acted cautiously in light of the American experience during the early 1970s, when several new forms of unregulated options in those commodities (which were known as "London," "naked," and "dealer" options) first appeared. See Lower, *supra*, 1978 Duke L.J. at 1102-1109. Although some of those options provided legitimate investment opportunities, others resulted in largescale losses and highly publicized instances of fraud. *Ibid.* Congress consequently concluded that options involving newly regulated commodities should be allowed only in accordance with CFTC rules, regulations, and orders. 7 U.S.C. 6c(b) (1976). See generally S. Rep. No. 1131, *supra*, at 26, 41-42; H.R. Conf. Rep. No. 1383, *supra*, at 40. Congress gave the CFTC authority to permit or prohibit options trading in the newly regulated commodities. See 1 Snider, *supra*, at §§ 7.03-7.04; Markham, *supra*, at 66; Lower, *supra*, 1978 Duke L.J. at 1111.

4. *The CFTC's regulation of options.* Upon commencing operations in 1975, the CFTC began to examine whether option transactions in "new" commodities should be permitted. The CFTC initially promulgated interim rules that allowed the off-exchange offer and sale of such options under certain circumstances. See 41 Fed. Reg. 7774 (1976); *id.* at 44,560; *id.* at 51,808. Those rules did not allow trading of options on United States exchanges. *Id.* at 51,808. See 1 Snider, *supra*, at § 7.04.

By 1978, the Commission concluded that "the offer and sale of commodity options has for some time been and remains permeated with fraud and other illegal or unsound practices notwithstanding a substantial investment of the Commission's resources in

attempting to regulate rather than prohibit option trading." 43 Fed. Reg. 16,153, 16,155 (1978). It therefore adopted regulations prohibiting the domestic sale of most commodity options after June 1, 1978. *Id.* at 16,161; 17 C.F.R. 32.11 (1982). The regulations did, however, permit sales to continue in certain "trade options," which are purchased for commercial purposes relating to the commodity and are not marketed to the general public. See 17 C.F.R. 32.4(a) and 32.11(b) (1982); 1 Snider, *supra*, at § 7.14 (describing trade options). The Commission also permitted existing companies that dealt in the actual commodity to continue marketing of so-called "dealer options" under detailed conditions. 43 Fed. Reg. 52,467 (1978). See 1 Snider, *supra*, at §§ 7.05-7.06, 7.14.

Congress, which was then considering other amendments to the CEA, endorsed the CFTC's assessment by adopting a statutory ban on the marketing of options in the newly regulated non-agricultural commodities. See Futures Trading Act of 1978, Pub. L. No. 95-405, § 3, 92 Stat. 867. Like the CFTC, Congress included an exception for dealer and trade options, and it authorized the CFTC to develop a program, subject to congressional approval, for exchange-traded options. *Ibid.*, codified at 7 U.S.C. 6c(c)-(e) (Supp. II 1978); see S. Rep. No. 850, 95th Cong., 2d Sess. 14 (1978).

In 1981, the CFTC announced a three year "pilot program" for trading of options on futures contracts on exchanges designated as contract markets. 46 Fed. Reg. 54,570 (1981). Congress authorized the CFTC to extend the pilot program to agricultural commodities, see Futures Trading Act of 1982, Pub. L. No. 97-444, Tit. II § 206, 96 Stat. 2301, and the CFTC correspondingly expanded the program, see 47 Fed. Reg. 56,996 (1982). In 1984, the CFTC increased the number of options a particular contract market could offer. 49 Fed. Reg. 33,641 (1984). The CFTC ended the pilot program two years later by adopting final regulations allowing exchange-traded commodity options. 51 Fed. Reg. 27,529 (1986). See Futures Trading Act of 1986, Pub. L. No. 99-641, § 102, 100 Stat. 3557; see generally 1 Snider, *supra*, at §§ 3.01-3.02.

Since that time, Congress has made other revisions to the CEA. See Futures Trading Practices Act of 1992, Pub. L. No. 102-546, 106 Stat. 3590; CFTC Reauthorization Act of 1995, Pub. L. No. 104-9, 109 Stat. 154. The 1992 Amendments are particularly significant because they grant the CFTC broad exemptive authority, similar to that contained in Section 6c respecting options, respecting other transactions that are subject to CEA regulation. See § 502(a)(2), 106 Stat. 3629; 7 U.S.C. 6(c) and (d). That exemption authority gives the CFTC additional flexibility to exempt appropriate agreements, contracts, and transactions from CEA requirements. See, *e.g.*, 17 C.F.R. 35.2 (the so-called swaps exemption).

B. Regulation Of Foreign Currency Futures And Options

At the time that Congress was considering the CFTC Act of 1974, an off-exchange market had developed for trade in foreign currency futures. See S. Rep. No. 1131, *supra*, at 94 (Appendix III); City of New York Bar Ass'n Comm. on Futures Regulation, *The Evolving Regulatory Framework For Foreign Currency Trading* (1986). That market grew

out of privately negotiated transactions between commercial banks, multi-national corporations, and sophisticated investors who entered into those transactions for both commercial hedging and speculative purposes. *Id.* at 3. Congress responded to the existence of that market by including within the CFTC Act a provision currently known as the Treasury Amendment to the CEA.

1. *The Treasury Amendment.* The Treasury Amendment originated in concerns expressed in a July 30, 1974, letter from the Department of the Treasury's Acting General Counsel to the Chairman of the Senate Committee on Agriculture and Forestry. See S. Rep. No. 1131, *supra*, at 49-51 (reproduced at App. B, *infra*, 10a-14a). The Acting General Counsel warned that, as a result of the proposal to expand the CEA definition of the term "commodity" through the CFTC Act, financial instruments such as foreign currency futures and government securities futures, which were then traded among banks and other sophisticated institutions, could become subject to new and unnecessary regulation. *Ibid.*

The Treasury Department suggested that the pending legislation include additional language that would expressly exclude from regulation transactions in foreign currency and other specified financial instruments. See S. Rep. No. 1131, *supra*, at 50-51. Congress responded by incorporating the Department's proposed statutory language, except as to "puts and calls on securities." The Treasury Amendment provides in pertinent part:

> Nothing in this chapter shall be deemed to govern or in any way be applicable to transactions in foreign currency, * * * unless such transactions involve the sale thereof for future delivery conducted on a board of trade.

7 U.S.C. 2(ii). At the time that the Treasury Department proposed the Treasury Amendment, it made specific reference to the foreign currency futures market. See S. Rep. No. 1131, *supra*, at 49-51. But the Treasury Department made no mention of any market in foreign currency options. That market did not develop until some time later in the 1970s, when banks began trading foreign currency options on a commercial scale. See Comm. on Futures Regulation, *supra*, at 18, 23.

2. *The SEC/CFTC Accord.* Following the enactment of the CFTC Act, both national securities exchanges and futures exchanges sought to market and trade in new financial products, which led to questions concerning the CFTC's jurisdiction. Of particular relevance here, the Chicago Board of Trade and the Securities and Exchange Commission (SEC) became involved in a dispute over whether the SEC or the CFTC had jurisdiction to regulate options in mortgage-backed debt securities guaranteed by the Government National Mortgage Association (GNMA). See *Board of Trade of Chicago* v. *SEC*, 677 F.2d 1137 (7th Cir.), vacated as moot, 459 U.S. 1026 (1982).

The *Board of Trade* litigation was ultimately rendered moot by an inter-agency agreement between the SEC and the CFTC, sometimes referred to as the "Shad/Johnson" or "SEC/CFTC" Accord, which defined with greater precision the division of regulatory authority between the SEC and the CFTC respecting options on financial instruments. See *Joint Explanatory Statement of the Commodity Futures Trading*

Commission, and the Securities and Exchange Commission, reprinted in [1980-1982 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,332 (Feb. 2, 1982). Of particular significance here, the legislation implementing the Accord provides that the SEC shall exercise jurisdiction over the trading of foreign currency options on United States securities exchanges, but leaves unaffected the CFTC's authority over foreign currency options traded in other markets. See Act of Oct. 13, 1982, Pub. L. No. 97-303, 96 Stat. 1409, codified at 15 U.S.C. 77(b)(1), 78c(a)(10), 78i(g), 80a-2(a)(36), and 80b-2(a)(18) (1982); Futures Trading Act of 1982, Pub. L. No. 97-444, Tit. I, § 102, 96 Stat. 2296, codified at 7 U.S.C. 6c(f) (1982). The Senate Report accompanying the latter Act states:

> The trading of options on foreign currencies will be regulated by both agencies; the SEC will regulate these options when they are traded on a national securities exchange, the CFTC will regulate them when they are traded other than on a national securities exchange.

S. Rep. No. 384, 97th Cong., 2d Sess. 22 (1982). See also H.R. Rep. No. 565, 97th Cong., 2d Sess., Pt. 1, at 39 (1982) (CFTC has jurisdiction over all "[o]ptions directly on foreign curencies"); see generally 1 Snider, *supra*, at § 10.24.

3. *The ABT and Salomon Forex Litigation.* In the late 1970s, the CFTC began to encounter situations in which unscrupulous promoters fraudulently marketed foreign currency futures and options to the general public. In 1979, the CFTC brought an enforcement action against an entity organized by Arthur Economou called the American Board of

Trade (ABT). *CFTC* v. *American Board of Trade (ABT)*, 473 F. Supp. 1177 (S.D.N.Y. 1979), aff'd, 803 F.2d 1242 (2d Cir. 1986). ABT claimed to provide "an exchange and marketplace" for certain commodity options transactions, including foreign currency options. 803 F.2d at 1244. The CFTC charged that those unlicensed activities were unlawful under the CEA. Among its defenses, ABT asserted that the Treasury Amendment excluded its foreign currency option transactions from regulation under the CEA.

The district court rejected ABT's arguments, entered a judgment enjoining ABT from engaging in options transactions, and ordered ABT to reimburse injured customers. 803 F.2d at 1244-1246. The Second Circuit affirmed the district court's decision, specifically rejecting ABT's Treasury Amendment defense. The court of appeals agreed with the district court that "an option to buy or sell foreign currency is not a purchase or sale of the currency itself and hence is not a transaction 'in' that currency, but at most is one that relates to the currency." 803 F.2d at 1248 (citing 473 F. Supp. at 1182). Having found that ABT's options were not "transactions in foreign currency" for purposes of the Treasury Amendment, the court of appeals discerned no need to determine whether ABT's transactions fell within the Treasury Amendment's "board of trade" proviso. *Ibid.*

Several years later, litigation arose that again raised questions over the meaning of the Treasury Amendment. *Salomon Forex, Inc.* v. *Tauber*, 795 F. Supp. 768 (E.D. Va. 1992), aff'd, 8 F.3d 966 (4th Cir. 1993), cert. denied, 114 S. Ct. 1540 (1994). The *Tauber* litigation grew out of a private debt collection dispute. A foreign currency brokerage company, Salomon Forex, brought a diversity suit in

federal district court to enforce a trading debt against a sophisticated foreign currency trader, Dr. Laszlo Tauber. The trader principally argued that the debts were unenforceable because they arose from off-exchange futures and options transactions that were not conducted in compliance with the CEA. He contended that the Treasury Amendment exempted from CEA regulation only "spot" and "cash forward" foreign currency transactions, in which the parties anticipate actual delivery of the commodity. See 1 Snider, *supra*, at §§ 9.01, 10.04, 10.16.

The district court ruled that the trading debts were enforceable because the Treasury Amendment's reference to "transactions in foreign currency" exempted off-exchange foreign currency futures and options from CEA regulation. See 795 F. Supp. at 773. The Fourth Circuit affirmed, reasoning that the "broad and unqualified" phrase "transactions in foreign currency" reaches "*all* transactions in which foreign currencies are the subject matter, including options." 8 F.3d at 975. The Fourth Circuit distinguished the Second Circuit's decision in *ABT* on the basis that the *ABT* case involved a foreign currency options transaction conducted by "unsophisticated private individuals buying on an organized exchange." *Id.* at 977-978.

C. The Proceedings Below

On April 8, 1994, the CFTC filed a complaint in federal district court charging petitioners (as well as two additional corporate defendants, Delta Options Ltd. and Nopkine Co., Ltd.) with fraud in connection with commodity option transactions, in violation of 7 U.S.C. 6c(b) and 17 C.F.R. 32.9. The complaint alleged that Dunn and each corporation had

made misrepresentations to existing and prospective customers concerning the likelihood of profit and loss associated with trading commodity options and the true status of their invested funds. The options identified in the complaint consisted of various foreign currencies (Japanese yen, Australian dollars, German marks, British pounds, Canadian dollars, and Swiss francs) that are subject to futures trading on United States contract markets. The complaint also charged Dunn individually with liability for the corporations' fraud as an aider and abettor, in violation of 7 U.S.C. 13c(a), and as a controlling person, under 7 U.S.C. 13c(b). J.A. 4-14.

1. *The district court proceedings.* The CFTC moved the district court to appoint a temporary equity receiver to locate, preserve, and control all four defendants' property for the benefit of customers. That request was based primarily upon the serious allegations of fraudulent conduct, the apparent disappearance of more than $180 million of customers' funds, and the defendants' apparent transfer of a large sum of money from the United States to Switzerland in late 1993. On June 23, 1994, the district court granted the request for appointment of a temporary receiver. Pet. App. 1b-4b. In a separate memorandum, the district court concluded that its jurisdiction to enter the receivership was proper under *ABT*, *supra*. Pet. App. 5b-6b.

2. *The court of appeals' decision.* The court of appeals affirmed the district court's appointment of a temporary receiver. Pet. App. 1a-7a. The court first described the allegations leading to the CFTC's receivership request. The court explained that some of the defendants solicited investments from a number of individuals, partnerships, and companies who

were told that Delta Options would use the money to execute investment strategies involving the purchase and sale of puts and calls on various foreign currencies. The defendants then used those investments to trade options in the "off-exchange" market and create "exotic" positions involving foreign currencies, bearing names such as "strangles" and "boxes." Pet. App. 2a.

The court next described the elements of the fraudulent scheme as set forth in CFTC-submitted affidavits, none of which had been disputed in the district court. Those affidavits charged that Dunn and his agents had disseminated false information concerning the risks and rewards of currency trading and of investing with defendants. The affidavits also charged that investors were deceived about the success of defendants' trading and the status of investors' accounts. Pet. App. 2a. Moreover, some investors claimed that the defendants' misleading reports summarizing the putative market value of the investors' particular positions had caused them to "roll-over" their positions instead of cashing them out. *Id.* at 2a-3a.

The court found from the affidavits that the scheme began to unravel in the second half of 1993. Pet. App. 3a. Certain investors received communications in November and December of that year disclosing that the defendants had encountered massive trading losses and were unable to repay the investors' money. *Ibid.* Based upon that record, the appeals court concluded that

> whatever their original intent, defendants became engaged in an old-fashioned "Ponzi" scheme, accompanied by exotic financial vocabulary. The weekly print-outs suggested large returns, which convinced most investors to "roll over" their funds. So long as these funds and money from new investors exceeded losses, any investor who wished to "cash out" could be paid off. The losses, however, were too great to be offset by "roll-overs" or new money, and much of the investors' money has disappeared.

Id. at 4a. The court concluded that the CFTC's evidentiary proffer "sufficiently demonstrated that defendants deceived investors and caused investors to receive false reports" in violation of 7 U.S.C. 6c(b), and that Dunn was personally liable as an aider and abettor and a controlling person with respect to the violations at issue. Pet. App. 4a-5a.

The court then addressed whether trading in off-exchange foreign currency options is excluded from the CFTC's jurisdiction by the Treasury Amendment to the CEA, 7 U.S.C. 2(ii), and, in particular, whether the phrase "transactions in foreign currency" contained within that Amendment includes foreign currency options. Pet. App. 5a. The court concluded that its 1986 decision in *ABT* controlled that issue. As noted above, the court of appeals concluded in *ABT* that the purchase or sale of an option did not constitute a "transaction in foreign currency" and that the defendants' conduct was therefore not subject to the Treasury Amendment exclusion. *ABT*, 803 F.2d at 1248. The court of appeals acknowledged that the *ABT* panel could have reached the same result through a different rationale by concluding that the instruments at issue in *ABT* were traded on an exchange and were therefore subject to CEA regulation in any event by virtue of the "board of trade" clause of the Treasury Amendment. The court declined, however, to adopt that rationale, stat-

ing that "a later panel may not disregard the reasoning of a decision because an entirely different line of reasoning was available." Pet. App. 6a. The court of appeals was not persuaded by the arguments of various banks, participating as *amici curiae*, that a number of potentially detrimental effects could result from a holding that off-exchange foreign currency options fall within CEA jurisdiction. The court noted the CFTC's suggestion that those effects were "to a degree deflected" by the CFTC's trade option exemption from the CEA. *Id.* at 7a.

SUMMARY OF ARGUMENT

Petitioners contend that the CFTC lacks authority to bring this enforcement action because the Treasury Amendment precludes CEA regulation of all off-exchange foreign currency transactions, including the purchase and sale of foreign currency options. The scope of the Treasury Amendment has been a matter of some controversy, and the Department of the Treasury and the CFTC have expressed differing views on the issue, which involves important considerations of financial and regulatory policy. But at bottom, the issue before the Court is one of statutory construction, and petitioners' interpretation of the Act is, in the end, unpersuasive. By its terms, the Treasury Amendment excludes foreign currency futures from CEA regulation, provided that the futures transactions are conducted outside of a board of trade. The Treasury Amendment, however, does not extend that exclusion to foreign currency options.

A. Petitioners correctly acknowledge that a statute's text must ordinarily be regarded as the conclusive guide to the statute's meaning. See, *e.g.*, *Reves*

v. *Ernst & Young*, 507 U.S. 170, 177 (1993). Petitioners are mistaken, however, in their understanding of the Treasury Amendment's language. The Treasury Amendment, which employs the specialized terminology of the CEA, excludes from CEA regulation "transactions in foreign currency." 7 U.S.C. 2(ii). Petitioners' analysis, which rests on a selection of dictionary definitions of the words "transaction" and "in" to support their position, is inadequate because it fails to take into account the context in which those words are used here. See, *e.g.*, *Reno* v. *Koray*, 115 S. Ct. 2021, 2025 (1995).

The court of appeals correctly recognized that the Treasury Amendment's reference to "transactions in foreign currency" conveys a specific intention. The Treasury Amendment applies to the purchase and sale of foreign currency futures contracts, because those contracts legally obligate a buyer to purchase or sell the foreign currency at some future date and are therefore transactions "in" that commodity. But it does not exclude the purchase or sale of foreign currency option contracts, because those transactions result only in the grant of unilateral *rights* to buy or sell foreign currency at some future date and are therefore not transactions "in" the commodity itself. See Pet. App. 5a-6a; *CFTC* v. *American Board of Trade*, 803 F.2d 1242, 1248-1249 (2d Cir. 1986).

The court of appeals' interpretation of the Treasury Amendment is supported by other textual indicia of congressional intent. The CEA's provisions are quite consistent in either referring to options expressly, or using more encompassing terminology than transactions "in" a commodity, when referring to commodity options. For example, Congress dis-

tinguished between transactions "in" and transactions "involving" commodities in other sections of the CEA. The CEA's exclusive jurisdiction provision, 7 U.S.C. 2(i), and its general options provision, 7 U.S.C. 6c, both describe commodity options as transactions "involving"—rather than transactions "in"—the commodity. See, *e.g.*, *Brown* v. *Gardner*, 115 S. Ct. 552, 556 (1994).

Congress's use of terminology that distinguishes between transactions "in" and transactions "involving" a commodity should be respected. It reflects Congress's long-standing practice, reflected in 7 U.S.C. 6c, of regulating commodity options differently, and often more strictly, than commodity futures. From the inception of the CEA, Congress authorized trade in commodity futures, but it imposed a corresponding prohibition on the purchase and sale of commodity options. Congress preserved a regulatory distinction between commodity futures and commodity options when it enacted the CFTC Act, which also contained the Treasury Amendment. Hence, it is hardly surprising that Congress preserved a regulatory distinction between foreign currency futures and options in the Treasury Amendment.

The court's interpretation finds additional support in the Treasury Amendment's "board of trade" proviso. Although the Treasury Amendment generally excludes specific transactions from CEA regulation, its board of trade proviso sweeps back within the CEA's coverage those futures transactions that are conducted on a board of trade. But the board of trade proviso expressly applies only to futures transactions. Congress would have had no reason to limit the

board of trade proviso in that way unless it intended that only foreign currency futures—and not foreign currency options—would be excluded from regulation.

The court of appeals' interpretation finds additional textual support in a subsection of the general options provision, 7 U.S.C. 6c(f), which indicates that the CFTC has authority to regulate foreign currency options conducted outside of national securities exchanges. Congress added that provision in 1982 as part of its legislation that implemented the SEC/CFTC Jurisdictional Accord. Congress, which does not ordinarily amend statutes with surplusage, would have had no reason to include that provision if the Treasury Amendment already excluded foreign currency options from CFTC regulation. Cf. *Stone* v. *INS*, 115 S. Ct. 1537, 1545 (1995).

B. Petitioners acknowledge that when a statute speaks clearly to the matter at issue there is no need to go further. See *Metropolitan Stevedore Co.* v. *Rambo*, 115 S. Ct. 2144, 2147 (1995). They nevertheless argue that their construction is consistent with Congress's purposes in enacting the Treasury Amendment. Those arguments, however, are without merit. Petitioners assert that futures and options are functionally similar and that the Treasury Amendment should be interpreted to treat them in the same way. But as we have noted, Congress has consistently regulated options differently than futures, and its expressed intention to do so is the law. See *e.g.*, *Pension Benefit Guaranty Corp.* v. *LTV Corp.*, 496 U.S. 633, 646-647 (1990). Contrary to petitioners' contentions, the Treasury Amendment draws a clear and manageable line between the treatment of futures and options. In addition, the legislative history confirms

that the text of the Treasury Amendment expresses Congress's intent. And even if there were doubts respecting Congress's intent, this Court's practice would be to resolve those doubts in favor of a narrow construction of the Treasury Amendment's exclusion. See, *e.g.*, *City of Edmonds* v. *Oxford House, Inc.*, 115 S. Ct. 1776, 1780 (1995).

C. Petitioners also attempt to find support for their position in the fact that the Treasury Amendment has at times raised questions among federal agencies concerning the scope of their respective jurisdictions. That factor, however, should not affect the Court's inquiry. The only question before this Court is the scope of the Treasury Amendment's regulatory exclusion of "transactions in foreign currency." The court of appeals properly resolved that question on the basis of the statutory text. See, *e.g.*, *Estate of Cowart* v. *Nicklos Drilling Co.*, 505 U.S. 469, 475 (1992). As petitioners' amici note, the interbank foreign currency market may have a legitimate policy need for a broader regulatory exemption than the Treasury Amendment provides. But that is not a question for this Court.

ARGUMENT

THE TREASURY AMENDMENT DOES NOT EXCLUDE FOREIGN CURRENCY OPTIONS FROM REGULATION UNDER THE COMMODITY EXCHANGE ACT

INTRODUCTION

Congress enacted the Treasury Amendment to exclude an important class of financial transactions from regulation under the newly expanded version of the CEA. In recent years, the scope of the Treasury Amendment's exclusion of "transactions in foreign

currency" has produced considerable controversy. The Department of the Treasury, which first proposed the exclusion, has taken the view that the Treasury Amendment excludes both foreign currency futures and foreign currency options from regulation under the CEA, provided that those transactions are conducted outside of a board of trade. By contrast, the CFTC, which is the agency responsible for administering the CEA, has concluded that the Treasury Amendment does not exempt foreign currency options from CEA regulation.

The Treasury Department's view rests in part on important financial policy concerns. The Treasury Department, which is responsible for managing the international financial policy of the United States, urged Congress to enact the Treasury Amendment to promote an efficient off-exchange market in foreign currency and government securities for the benefit of banks and other sophisticated and informed institutions. See S. Rep. No. 1131, 93d Cong., 2d Sess. 49-51 (1974) (Letter of Donald Ritger Acting General Counsel, reproduced at App. B, *infra*, 10a-14a). The Department believes that because foreign currency futures and foreign currency options serve the same or similar purposes in the off-exchange market, they should enjoy the same exemption from CEA regulation. It is concerned that excessive domestic regulation may drive that market to overseas financial centers that provide a more hospitable regulatory environment. In those respects, the Treasury Department shares some of the views expressed by the petitioners' amici. See Amicus Br. of the Foreign Exchange Committee *et al.*; Amicus Br. of Crédit Lyonnais *et al.*

The CFTC also has an important policy perspective on the issue. The CFTC points out that unscrupulous

promoters have frequently employed commodity options as a device to take advantage of unsuspecting investors. See 1 Timothy J. Snider, *Regulation of the Commodities Futures and Options Markets* § 7.03 (2d ed. 1995) (describing abusive practices, including the infamous Goldstein-Samuelson commodity options scandal); Jerry W. Markham, *The History of Commodity Futures Trading and its Regulation* 57 (1987) (same); Robert C. Lower, *The Regulation of Commodity Options*, 1978 Duke L.J. 1102-1109 (same). In the CFTC's view, and as illustrated by the allegations in this case, the offer and sale of foreign currency options raises a similar potential for abusive or fraudulent practices. See J.A. 2-19 (Complaint).

Although there are important policy considerations on either side of the issue, the issue before this Court is ultimately one of statutory construction. The Court must "apply the statute as Congress wrote it" unless "doing so would frustrate Congress's clear intention or yield patent absurdity." *Hubbard* v. *United States*, 115 S. Ct. 1754, 1759 (1995). Approached from that perspective, petitioners' argument is unpersuasive. The Treasury Amendment excludes foreign currency futures contracts from CEA regulation, provided that those transactions are conducted outside of a board of trade. But the Treasury Amendment's precise terms do not extend that exclusion to foreign currency options. The CFTC has the power to exclude foreign currency option transactions from CEA regulation, and it may find that it is appropriate to exempt those transactions that are of concern to the Treasury Department and the various amici that have filed briefs in support of petitioners. But the court of appeals correctly concluded that the Treasury

Amendment does not provide an automatic exemption, and that court's decision should therefore be affirmed.

A. The Court Of Appeals Correctly Concluded That The Express Terms Of The Treasury Amendment Exclude Foreign Currency Futures, But Not Foreign Currency Options, From CEA Regulation

Petitioners correctly recognize that the principal source for determining a statute's meaning is the language of the statute itself, which must "ordinarily be regarded as conclusive." Pet. Br. 10. See *Reves* v. *Ernst & Young*, 507 U.S. 170, 177 (1993); *United States* v. *Turkette*, 452 U.S. 576, 580 (1981); *Consumer Product Safety Comm'n* v. *GTE Sylvania, Inc.*, 447 U.S. 102, 108 (1980). They properly note that the Court's task "is to apply the text, not to improve upon it." Pet. 10. See *Pavelic & LeFlore* v. *Marvel Entertainment Group*, 493 U.S. 120, 126 (1989); see also *Touche Ross & Co.* v. *Redington*, 442 U.S. 560, 578 (1979). But petitioners and their amici go astray in the application of those familiar principles. Specifically, they fail to construe the Treasury Amendment in light of the full scope and import of the CEA's language.

1. Petitioners' principal argument in support of their interpretation of the Treasury Amendment is that the "the plain language of the words 'transactions in foreign currency' means any commercial dealings involving foreign currency." Pet. Br. 10. They reach that conclusion by isolating the words "transactions" and "in" from one another and from the Treasury Amendment and the CEA as a whole, consulting a dictionary, and selecting definitions of the words "transaction" and "in" that support their position. *Id.* at 10-11 & n.8. Petitioners' approach

however, does not provide an adequate inquiry into the meaning of the Act.

As this Court has stated, "it is a fundamental principle of statutory construction (and, indeed, of language itself) that the meaning of a word cannot be determined in isolation, but must be drawn from the context in which it is used." *Reno* v. *Koray*, 115 S. Ct. 2021, 2025 (1995); *Deal* v. *United States*, 113 S. Ct. 1993, 1996 (1993); see also *King* v. *St. Vincent's Hospital*, 502 U.S. 215, 221 (1991). We therefore turn to the statutory context in which Congress used the phrase "transactions in foreign currency."

Section 2(i) of Title 7 provides the CFTC with a broad grant of authority over commodity futures. 7 U.S.C. 2(i). Section 2(i) states (subject to certain exceptions not relevant here):

> The Commission shall have exclusive jurisdiction * * * with respect to *accounts, agreements* (including any transaction which is of the character of, or is commonly known to the trade as, an "option," "privilege," "indemnity," "bid," "offer," "put," "call," "advance guaranty," or "decline guaranty"), and *transactions* involving *contracts of sale of a commodity for future delivery*, traded or executed on a contract market designated pursuant to section 7 of this title or any other board of trade, exchange, or market * * *.

7 U.S.C. 2(i) (emphasis added). By its terms, Section 2(i) gives the CFTC exclusive jurisdiction over "accounts," "agreements," and "transactions" involving futures contracts. 7 U.S.C. 2(i). That grant of jurisdiction expressly includes authority over agreements that constitute an "option" to buy or sell a futures contract. 7 U.S.C. 2(i). See 1 Snider, *supra*, at § 10.11.

Section 6c of Title 7 gives the CFTC additional (albeit nonexclusive) authority over options. 7 U.S.C. 6c. Section 6c(b) provides in pertinent part as follows:

> No person shall offer to enter into, enter into or confirm the execution of, any transaction involving any commodity regulated under this chapter which is of the character of, or is commonly known to the trade as, an "option" * * *, contrary to any rule, regulation, or order of the Commission prohibiting any such transaction or allowing any such transaction under such terms and conditions as the Commission shall prescribe.

7 U.S.C. 6c(b). That provision, by its terms, is not limited to options on commodity futures contracts, but also includes options to buy or sell the "physical" commodity itself. See 1 Snider, *supra*, at § 10.12.

The Treasury Amendment—7 U.S.C. 2(ii)—is a part of that statutory framework, and it should be interpreted in light of the context provided by the foregoing provisions, all of which were enacted in 1974. See *Massachusetts* v. *Morash*, 490 U.S. 107, 115 (1990); *Pilot Life Ins. Co.* v. *Dedeaux*, 481 U.S. 41, 51 (1987). Specifically, the Treasury Amendment should be construed on the basis, demonstrated in 7 U.S.C. 2(i) and 6c, that Congress understood and knew how to express the distinction among futures contracts, options on futures contracts, and options on the physical commodity.

2. The Treasury Amendment excludes a particular class of "transactions" from CEA regulation. It provides in pertinent part:

> Nothing in this chapter shall be deemed to govern or in any way be applicable to *transactions*

> *in foreign currency*, * * * unless *such transactions involve the sale thereof for future delivery* conducted on a *board of trade.*

7 U.S.C. 2(ii) (emphasis added). When read in light of the terminology of the CEA, those words have a definitive and circumscribed reach.

The Treasury Amendment's reference to "transactions in foreign currency" clearly excludes foreign currency futures contracts from CEA regulation unless they are conducted on a board of trade. A foreign currency futures contract legally obligates the seller to deliver a currency and the buyer to pay for it on a specified future date. See, *e.g.*, Lower, *supra*, 1978 Duke L.J. at 1096 n.3. The contract's creation of legal obligations respecting the sale and delivery of the commodity is a "transaction in" the commodity, even if (as is typically true in common experience) the transaction ultimately is extinguished before delivery by entry into an offsetting futures contract. 1 Snider, *supra*, at § 2.05. The same conclusion would hold true, a fortiori, for "spot" and "cash forward" transactions, which envision actual delivery of the commodity and are generally exempt from the CEA in any event. See 7 U.S.C. 1a(11); see also 1 Snider, *supra*, at § 9.01.

As the court of appeals recognized in *ABT* and reaffirmed in this case, however, there is a linguistic difficulty in describing an option to buy or sell foreign currency as a "transaction[] in foreign currency." 7 U.S.C. 2(ii). The purchaser of a commodity option enters into an agreement in which he pays a sum certain in return for an irrevocable offer to buy or sell the commodity at a specified price during the life of the option. See, *e.g.*, Lower, *supra*, 1978 Duke L.J. at 1096 nn.2 & 3. The purchase or sale of a commodity option is undeniably a "transaction," and it *involves* a commodity, but it is not a "transaction *in*" the commodity. Rather, it is a transaction in the *right* to buy or sell the commodity, *ibid.*—*i.e.*, the right to enter into a "transaction[] involving foreign currency" at some point in the future. The court of appeals accordingly was correct in concluding that an option to buy foreign currency is not itself a "transaction[] in foreign currency." Under the court's reasoning, the purchase or sale of a foreign currency option is not excluded from CEA regulation, although the actual exercise of an option (i.e., the actual purchase or sale of foreign currency) would be an exempt "transaction[] in foreign currency." See Pet. App. 5a-6a; *ABT*, 803 F.2d at 1248; see also *Board of Trade*, 677 F.2d at 1146 & n.17, 1154.

That construction is consistent with the other terminology used in the Treasury Amendment. For example, the Treasury Amendment expressly includes transactions in "repurchase options" among the financial transactions that are excluded from CEA regulation. See 7 U.S.C. 2(ii). That usage indicates that Congress was aware of specialized "options" terminology and suggests that Congress would have included foreign currency options as well if that was its intention.*

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* The Treasury Amendment also excludes from CEA coverage "transaction in * * * security warrants [and] security rights," unless such transactions involve sales thereof for future delivery conducted on a board of trade. The terms "security warrants" and "security rights" can be understood to include options on securities. See S. Rep. No. 1131, *supra*, at 26 (stating that the CFTC "would not have authority to regulate trading in puts and calls for securities"). The Seventh

3. The court of appeals' analysis is also consistent with the language that Congress employed in 7 U.S.C. 2(i) and 6c(b). For example, when Congress wished to include options on futures contracts within the CFTC's exclusive jurisdiction, it employed the term "agreements * * * *involving* contracts of sale of a commodity for future delivery," 7 U.S.C. 2(i), which aptly describes the nature of an option. Similarly, when Congress authorized the CFTC to regulate options trading, it made reference to "any transaction *involving* any commodity * * * which is of the character of, or is commonly known to the trade as, an 'option.'" 7 U.S.C. 6c(b). In each case, when Congress spoke to the treatment of options, it employed terminology that made its intention plain. Congress's failure to use that terminology in Section 2(ii) indicates that Congress did not intend that the Treasury Amendment would include foreign currency options within its reach. See *Brown* v. *Gardner*, 115 S. Ct. 552, 556 (1994); *Russello* v. *United States*, 464 U.S. 16, 23 (1983).

Although petitioners acknowledge Sections 2(i) and 6c(b), they suggest that Congress's mere use of the word "transaction" in association with options provides a sufficient basis for concluding that the Treasury Amendment excludes options from regulation. See Pet. Br. 12-13 (citing Section 2(i)'s reference to "any transaction which is of the character of, or is commonly known to the trade as, an 'option'").

Circuit partially rejected that reading in its *Board of Trade* decision, see 677 F.2d at 1154 & n.32; cf. *id.* at 1156-1157, but the government challenged the Seventh Circuit's conclusion in its petition for a writ of certiorari in the *Board of Trade* case (No. 82-256 Pet. 21 n.21), and this Court subsequently vacated the Seventh Circuit's decision as moot, 459 U.S. 1026 (1982).

But contrary to petitioners' reasoning, the question is not whether the purchase or sale of a foreign currency option is a "transaction"—it undeniably is. Rather, the question is whether the purchase or sale of a foreign currency option is a "transaction[] *in* foreign currency." As we explain above, it is not.

The CEA's provisions are quite consistent in either referring to options expressly, or using more encompassing terminology than transactions "in" a commodity, when referring to commodity options. Petitioners' citation of 7 U.S.C. 5 is not to the contrary. See Pet. Br. 13. Section 5 states:

> Transactions in commodities involving the sale thereof for future delivery as commonly conducted on boards of trade and known as 'futures' are affected with a national public interest.

7 U.S.C. 5. That statement, which is part of Congress's legislative findings, uses the formulation of "[t]ransactions in commodities involving the sale thereof for future delivery," but it also makes clear, by specific reference, that it is describing "futures." Moreover, Section 5 specifically refers elsewhere to "options transactions," 7 U.S.C. 5, thereby confirming that Congress distinguished between the two and acted intentionally in its disparate use of language.

4. Petitioners and their amici suggest that the court of appeals' interpretation places inordinate weight on the difference between a "transaction in" and a "transaction involving" foreign currency. See Pet. Br. 11 n.8. But Congress itself employed that distinction, and its reasons for doing so cannot be brushed aside as sloppy draftsmanship. To the contrary, Congress's purpose is illuminated by 7 U.S.C. 6c(b). That Section reflects Congress's historic prac-

tice, described at pages 3-11, *supra*, of regulating options differently, and more strictly, than futures.

From its inception, the CEA authorized trading in commodity futures, but until 1974, the Act imposed a corresponding prohibition on the purchase and sale of commodity options. See ch. 545, § 5, 49 Stat. 1494 (adding Section 4c of the CEA), codified at 7 U.S.C. 6c (1970). The CFTC Act preserved that ban with respect to traditional commodities, but gave the CFTC power to regulate or prohibit options in newly included commodities. See Commodity Futures Trading Commission Act of 1974, Pub. L. No. 93-463, Tit. IV, § 402, 88 Stat. 1412, codified at 7 U.S.C. 6c(a) and (b) (1976). When the CFTC adopted a regulation banning virtually all transactions in commodity options (43 Fed. Reg. 16,153 (1978)), Congress soon thereafter adopted an analogous statutory prohibition, see Futures Trading Act of 1978, Pub. L. No. 95-405, § 3, 92 Stat. 867, codified at 7 U.S.C. 6c(b) (Supp. II 1978), which it left in place until 1982. See Futures Trading Act of 1982, Pub. L. No. 98-444, Tit. II, § 206, 96 Stat. 2301, codified at 7 U.S.C. 6c (1982); Futures Trading Act of 1986, Pub. L. No. 99-641, Tit. I, § 102, 100 Stat. 3557, codified at 7 U.S.C. 6c (Supp. IV 1986).

Congress's adoption and subsequent amendments of 7 U.S.C. 6c demonstrate that it has consistently elected to regulate options differently from futures. It did so in the CFTC Act, which contained the Treasury Amendment. It is therefore unsurprising that Congress followed that practice in the Treasury Amendment with respect to foreign currency options. Congress accomplished that result by limiting the reach of the Treasury Amendment to "transactions in"—rather than "transactions involving"—foreign currency. See *ABT*, 803 F.2d at 1246-1248.

5. Congress's consistent practice of regulating options differently from futures has additional textual significance in light of the Treasury Amendment's "board of trade" proviso. As noted above, the Treasury Amendment provides in pertinent part:

> Nothing in this chapter shall be deemed to govern or in any way be applicable to transactions in foreign currency [and other specified financial instruments], *unless such transactions involve the sale thereof for future delivery conducted on a board of trade.*

7 U.S.C. 2(ii) (emphasis added). By its terms, the Treasury Amendment excludes "transactions in" foreign currency (and other financial instruments) from CEA regulation, but the board of trade proviso sweeps back within the CEA's coverage those "transactions" that "involve the sale thereof for future delivery conducted on a board of trade." As noted in our brief in opposition (Br. in Opp. 11-12), the meaning of the term "board of trade" is subject to dispute. But whatever interpretive difficulties that term presents, the board of trade proviso clearly applies only to *futures contracts* (commodity transactions involving the "sale thereof for future delivery") and does not apply to options.

The specific phraseology of the board of trade proviso is highly pertinent because it provides another indication that the Treasury Amendment as a whole does not reach options. As noted above, the CEA has consistently regulated options differently, and usually more strictly, than futures. Hence, one would expect that if Congress had intended to exclude both foreign currency futures and foreign currency options from CEA regulation, Congress would not only have made

that intention clear through specific "options" terminology in the opening clause of the Treasury Amendment, but it would also have made clear that both futures and options are subject to the Amendment's board of trade proviso. Congress's use of specific language in the board of trade proviso that clearly does *not* embrace options strongly suggests that Congress did not intend that the Treasury Amendment would exclude foreign currency options from regulation under the CEA in the first place.

6. Section 6c(f) of Title 7 provides yet another source of textual support for the court of appeals' conclusion. As we explain above, Congress enacted legislation in 1982 to resolve a jurisdictional dispute between the SEC and the CFTC over which agency had authority to regulate foreign currency options traded on national securities exchanges. See pages 13-14, *supra*. Congress amended Section 9(g) of the Securities Exchange Act to clarify that the SEC has exclusive jurisdiction over, among other things, options on foreign currency when traded on a national securities exchange. See 15 U.S.C. 78i(g).

In addition, Congress enacted 7 U.S.C. 6c(f) (see Pub. L. No. 97-444, Tit. I, § 102, 96 Stat. 2296), which states:

> Nothing in this chapter shall be deemed to govern or in any way be applicable to any transaction in an option on foreign currency traded on a national securities exchange.

7 U.S.C. 6c(f). Although Section 6c(f) does not expressly grant any jurisdiction to the CFTC, the provision implies that the CFTC would have jurisdiction over foreign currency options that are not traded on a national exchange. The legislative history supports

that implication. See S. Rep. No. 384, 97th Cong., 2d Sess. 22 (1982) ("the CFTC will regulate [foreign currency options] when they are traded other than on a national securities exchange"); H.R. Rep. No. 565, 97th Cong., 2d Sess., Pt. 1, at 38 (1982) ("the CFTC will have jurisdiction to regulate the trading of options on foreign currency in the commodities markets"); *id.* at 39 (CFTC has jurisdiction over all "[o]ptions directly on foreign currency"). Section 6c(f) would have been unnecessary if the Treasury Amendment granted foreign currency options a blanket exclusion from CFTC regulation. Hence, it provides an additional indication that the Treasury Amendment does not exclude foreign currency options from regulation. Cf. *Stone* v. *INS*, 115 S. Ct. 1537, 1545 (1995) ("When Congress acts to amend a statute, we presume it intends its amendment to have real and substantial effect.").

B. The Court Of Appeals' Interpretation Is Consistent With The Purposes Of The Treasury Amendment

As this Court has stated, "when a statute speaks with clarity to an issue, judicial inquiry into its meaning, in all but the most extraordinary circumstance, is finished." *Metropolitan Stevedore Co.* v. *Rambo*, 115 S. Ct. 2144, 2147 (1995); *Estate of Cowart* v. *Nicklos Drilling Co.*, 505 U.S. 469, 475 (1992); *Demerest* v. *Manspeaker*, 498 U.S. 184, 190 (1991). Petitioners acknowledge that principle, Pet. Br. 16, but they also suggest that their interpretation is consistent with Congress's policy and general purposes in adopting the Treasury Amendment, *id.* at 13-15, 16-20. Petitioners' arguments, however, are not well founded.

1. Petitioners and their *amici* argue that because the Treasury Amendment excludes foreign currency

futures from regulation, it must also exclude options. They contend that foreign currency futures and options serve similar purposes to "hedge and/or shift risk," and that it is "completely illogical" to interpret the Treasury Amendment in a way that regulates one but not the other. Pet. Br. 13-14. But one could just as easily argue that grain futures and grain options serve interchangeable purposes and should be regulated the same way. Yet, as we have explained above, Congress has consistently concluded that public policy requires that grain options be regulated more strictly than grain futures. See pages 3-9, *supra*. In the case of foreign currency, Congress has expressed its intention in the Treasury Amendment through statutory language that draws a distinction between futures and options. This Court should not alter that result by resorting to general notions of statutory purpose in place of specific statutory language. See, *e.g.*, *Pension Benefit Guaranty Corp.* v. *LTV Corp.*, 496 U.S. 633, 646-647 (1990); *Rodriguez* v. *United States*, 480 U.S. 522, 525-526 (1987).

Congress had a reasonable basis in 1974 for concluding that options and futures should not be treated the same. Foreign currency market participants may consider futures and options as functionally and economically similar. But commentators have noted that "there are a number of important practical distinctions between commodity options and commodity futures contracts." Lower, *supra*, 1978 Duke L.J. at 1097 n.3 (noting that futures are subject to margin calls but options are not); see also 1 Snider, *supra*, at §§ 7.01-7.02. Furthermore, some courts have suggested that options create more serious risks of abusive practices and fraud. See *British*

American Commodity Options Corp. v. *Bagley*, 552 F.2d 482, 485 (2d Cir.) ("the options market may be peculiarly attractive to individual investors of relatively modest means and with a propensity for taking risks"), cert. denied, 434 U.S. 938 (1977); *Kelley* v. *Carr*, 442 F. Supp. 346, 349 (W.D. Mich. 1977) ("owing to the ease of market entry, * * * fly-by-night organizations are often attracted"), aff'd in part, rev'd in part, 691 F.2d 800 (6th Cir. 1980). In light of those considerations, Congress was entitled to conclude at the time that it enacted the Treasury Amendment that foreign currency options should not be included within the statutory exclusion. See 1 Snider, *supra*, at § 7.01 (noting that "well-publicized scandals * * * have led to governmental action to regulate restrictively and, in some cases, to ban the sale of commodity options").

2. Petitioners also contend that the court of appeals' construction would lead to an unmanageable situation because the court suggested that the actual exercise of an option is a "transaction in foreign currency." See Pet. App. 6a. They argue that, as a result, the regulation of an option would depend on whether or not it was ultimately exercised. Pet. Br. 14-15. Petitioners posit, however, a problem that does not really exist. Under the court's construction, the Treasury Amendment does not exclude from CEA regulation the purchase or sale of a foreign currency option (*i.e.*, the purchase or sale of a *right* to buy or sell a foreign currency at a prescribed price). It does, however, exclude from regulation the subsequent purchase or sale of the foreign currency itself, even though the right to enter into that subsequent transaction was acquired pursuant to an option that is subject to CEA regulation. Hence, the

court of appeals' reasoning results in a clearly demarked line: The purchase or sale of an option is subject to CEA regulation, but the transaction resulting from its subsequent exercise is not. Contrary to the arguments of petitioners and their amici, it poses no uncertainty over what transactions are subject to CEA regulation.

3. Petitioners additionally rely on the legislative history of the Treasury Amendment. Pet. Br. 16-20. The legislative history, however, does not support their position. As they note, the Acting General Counsel of the Treasury Department first proposed the legislation. See S. Rep. No. 1131, *supra*, at 49-51 (Letter from Donald L.E. Ritger, Acting General Counsel of the Department of the Treasury, to Senator Herman E. Talmadge, Chairman, Senate Committee on Agriculture and Forestry (July 30, 1974)), reproduced at App. B, *infra*, 10a-14a. The Treasury Department expressed concern about the prospect that the proposed CFTC Act would result in regulation of *futures trading* in foreign currencies, but it made no mention of foreign currency options. See *ibid.*

The portions of the Department's letter on which petitioners themselves rely demonstrate that the Department was concerned at that time with futures and not options:

> The Department believes the bills contain an ambiguity that should be clarified. The provisions of the bills do not clearly indicate that the new regulatory agency's authority would be limited to the regulation of *futures trading* on organized exchanges, and would not extend to *futures trading* in foreign currencies off organized exchanges. * * *

> The Department feels strongly that *foreign currency futures trading*, other than on organized exchanges, should not be regulated by the new agency. Virtually all *futures trading* in foreign currencies in the United States is carried out through an informal network of banks and dealers. This dealer market, which consists primarily of the large banks, has proved highly efficient in serving the needs of international business in hedging the risks that stem from foreign currency exchange rate movements.

S. Rep. No. 1131, *supra*, at 49-50 (emphasis added); see Pet. Br. 17-18. The letter made specific reference to the potential regulation of "futures contracts," S. Rep. No. 1131, *supra*, at 50, and it suggested that other specific types of financial instruments (including some types of options) should be exempt from regulation, *id.* at 51, but it made no mention of foreign currency options. The letter urged only that the Committee "amend the proposed legislation to make clear that its provisions would not be applicable to futures trading in foreign currencies or other financial transactions of the nature described above other than on organized exchanges." *Ibid.* Congress adopted the Treasury Department's proposed language virtually verbatim. See *ibid.* (setting out the proposed language).

The Treasury Department's failure to address foreign currency options is understandable, because the market for that type of option apparently did not exist at that time. See Comm. on Futures Regulation, *supra*, at 18, 23; see also page 13, *supra*. That fact simply underscores that the Treasury Amendment should not be construed to reach foreign currency options unless the statutory language is

sufficiently broad to anticipate and encompass their eventual development. The Treasury Department's letter, which itself fails to herald their appearance, cannot accomplish that result.

Petitioners also suggest that an excerpt from the Senate Committee Report suggests that the Treasury Amendment has a broader meaning. See Pet. Br. 19. That excerpt, reproduced as it appears in the Report, states:

> Section 201 of the bill enlarges the definition of "commodity" to include all goods and articles, except onions, and "all services rights and interests in which contracts for future delivery are presently or in the future dealt in", and provides for the exclusive jurisdiction over all futures transactions which are executed on domestic boards of trade. The Commission will have exclusive jurisdiction over options trading in commodities (but not in securities).
>
> However, transactions in foreign currency, security warrants and rights, resales of installment loan contracts, repurchase options, government securities or mortgages and mortgage purchase commitments would not be subject to the Act unless they involve the sale thereof for future delivery conducted on a board of trade.

S. Rep. No. 1131, *supra*, at 31. Once that excerpt is set out with correct punctuation, compare Pet. Br. 19, one can see that it adds nothing new to the analysis. It simply restates the statutory language, including the limiting phrase "transactions in foreign currency." Compare 7 U.S.C. 2(ii).

4. Even if petitioners' concerns were sufficient to raise doubts about the reach of the Treasury Amendment, those doubts are insufficient to overcome the

court of appeals' interpretation. When this Court encounters doubts about the scope of a statutory provision that creates an exception to a general rule, this Court will normally read the exception narrowly in order to preserve the primary object of the legislation. See *City of Edmonds* v. *Oxford House, Inc.*, 115 S. Ct. 1776, 1780 (1995); *Commissioner* v. *Clark*, 489 U.S. 726, 739 (1989); *Phillips, Inc.* v. *Walling*, 324 U.S. 490, 493 (1945). That approach is particularly appropriate here, where the CFTC has statutory authority to exempt the conduct at issue from regulation if the CFTC determines that there is no need for regulatory oversight. See pages 10-11, *supra*.

C. Inter-Agency Disagreements Over The Scope Of The Treasury Amendment Should Not Alter This Court's Analysis Of The Statutory Text

The Treasury Amendment has sometimes prompted disagreement among the Treasury Department, the SEC, and the CFTC concerning their respective powers. Petitioners attempt to find support for their position in those inter-agency disagreements. Pet. Br. 21-25. Their description of those controversies, however, is neither accurate nor complete. In any event, those inter-agency disagreements should not affect how the Court resolves the issue before it, which involves purely a question of statutory construction.

1. Since its creation, the CFTC has faced various issues concerning the scope of its regulatory jurisdiction. See 1 Snider, *supra*, at §§ 10.01-10.26. As noted above, the *Board of Trade* litigation raised issues regarding the respective jurisdictions of the SEC and the CFTC with respect to options on GNMA securities. See pages 13-14, *supra*. The United States

Court of Appeals for the Seventh Circuit ruled in that case that the SEC lacked authority to regulate exchange-traded options in those securities, holding among other things that those options on the physical commodity—GNMA securities—were within the exclusive jurisdiction of the CFTC by virtue of the CEA's exclusive jurisdiction provision, now codified at 7 U.S.C. 2(i). See 677 F.2d at 1146. The court also ruled that the options were not exempted by the Treasury Amendment, concluding, like the court of appeals in this case, that options are not "transactions in" the underlying commodity. *Id.* at 1154. The court stated that the GNMA options would also fall within the Treasury Amendment's "board of trade" proviso, because "GNMA options 'involve' GNMA futures contracts presently being traded on the various contract markets including the Board of Trade." *Ibid.*

The United States petitioned for a writ of certiorari in that case, arguing, among other things, that the CFTC did not have exclusive jurisdiction to regulate trading in options on GNMA securities. See Pet. at 16-22, *SEC* v. *Board of Trade of Chicago*, No. 82-526. The United States contended, as we have explained herein at pages 28-29, *supra*, that the CEA's exclusive jurisdiction provision, 7 U.S.C. 2(i), applies to options on futures contracts, but not options on the physical commodity. 82-526 Pet. at 18-20. The United States also contended that the court had misinterpreted the Treasury Amendment's "board of trade" proviso. *Id.* at 20-22. But the United States did not challenge the court of appeals' ruling that a commodity option is not a "transaction in" the underlying commodity. See *ibid.*

Petitioners are accordingly mistaken in their assertion (Pet. Br. 23) that the United States has previ-

ously taken the position in this Court that a commodity option is a "transaction in" the underlying commodity. The United States challenged the *Board of Trade* decision on quite different grounds that are consistent with the government's position in this case. The Board of Trade litigation became moot while the government's certiorari petition was pending by virtue of the SEC/CFTC Jurisdictional Accord and implementing legislation. See *SEC* v. *Board of Trade of Chicago*, 459 U.S. 1026 (1982). And as we have explained, pages 36-37, *supra*, the implementing legislation supports the view that the Treasury Amendment does not exclude foreign currency options from CEA regulation. See 7 U.S.C. 6c(f).

2. The Treasury Department and the CFTC have also disagreed over the scope of the CFTC's jurisdiction. In 1985, during the pendency of the *ABT* litigation, the CFTC issued a statutory interpretation stating that the Treasury Amendment divested the CFTC of jurisdiction over "transactions in foreign currency" (7 U.S.C. 2(ii)) only "when such transactions are entered into by and between banks and certain other sophisticated and informed institutional participants." See *Trading in Foreign Currencies for Future Delivery*, [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,750 (CFTC Oct. 23, 1985) (statutory interpretation and request for comments), 50 Fed. Reg. 42,983 (1985). The Treasury Department transmitted comments to the CFTC that disagreed with the CFTC's construction and asserted that the Treasury Amendment "contains no language limiting the coverage of the exemption based upon the characteristics of participants in a transaction." Letter of Charles O. Sethness, Assistant Secretary of the Treas-

ury (May 5, 1986) (reproduced at Pet. App. 27d-29d).

The *Tauber* litigation, discussed at pages 15-16, *supra*, later became a focal point of that disagreement. The district court in that case rejected Tauber's argument that he was not obligated to pay foreign currency trading debts consummated without observance of CEA regulations, reasoning that the Treasury Amendment broadly excluded his futures and exercised options transactions from regulation. See 795 F. Supp. at 773, 775-776. The CFTC, which has independent litigation authority in the lower courts, filed an amicus curiae brief in that case urging the court of appeals to affirm the district court's judgment, but it proposed a theory that was different, in part, from the one that the district court advanced. The CFTC suggested that the Treasury Amendment would exclude Tauber's futures transactions from regulation if the court decided that Tauber's activities qualified him as a "sophisticated and informed institution." See CFTC Amicus Br. at 10, 17, in *Salomon Forex, Inc.* v. *Tauber*, No. 92-1406 (4th Cir.). The CFTC also suggested, in accordance with the district court's decision, that "the Treasury Amendment excludes performance obligations which arise once options on foreign currency are exercised." *Id.* at 11, 19-20. See 795 F. Supp. at 775-776.

At the request of the Treasury Department, the United States also filed an amicus curiae brief in *Tauber*. The United States urged affirmance, but solely on the theory advanced by the district court. The United States argued that the Treasury Amendment excluded Tauber's futures contracts from CEA requirements, explicitly agreeing with the district

court that "the phrase 'transaction in foreign currency' plainly and unambiguously means any transaction, without limitation as to the participants involved, in the commodity or subject matter." Pet. App. 19d-20d (reproducing the United States' brief). The United States also suggested that the "transactions in" language served to exclude options from coverage as well, *id.* at 22d-23d, but it concluded that the court of appeals did not need to address that question because the district court had found that the options in that case had been exercised, *id.* at 23d-24d.

Although the United States adheres to the view it expressed in *Tauber* that the Treasury Amendment exempts foreign currency *futures* from CEA regulation, subject only to the "board of trade" proviso, it has reconsidered the position expressed in *Tauber* with respect to foreign currency options. See page 46, *supra*. Upon further and extensive consideration of the Treasury Amendment and the CEA as a whole, set forth in the foregoing pages, we have concluded that the United States' suggestion in *Tauber* that foreign currency options are "transactions in foreign currency" was not correct. Heeding Justice Frankfurter's observation that newly acquired wisdom should not be rejected merely because it arrives late, see *Henslee* v. *Union Planters Bank*, 335 U.S. 595, 600 (1949) (Frankfurter, J., dissenting), the United States has modified its position on the basis of a more detailed analysis of the Act.

3. Petitioners suggest that "to the extent this Court determines an agency interpretation of the Treasury Amendment is relevant, it should look to the long-standing views of the Treasury Department." Pet. Br. 22. That argument, however, is inconsistent

with basic principles respecting judicial deference to agency interpretations. This Court gives deference to "the reasonable judgments of agencies with regard to the meaning of ambiguous terms in statutes that they are charged with administering." *Smiley* v. *Citibank (South Dakota), N.A.*, 116 S. Ct. 1730, 1733 (1996); *Chevron U.S.A. Inc.* v. *Natural Resources Defense Council, Inc.*, 467 U.S. 837, 842-845 (1984). The CFTC is responsible for administering the CEA, *CFTC* v. *Schor*, 478 U.S. 833, 844-46 (1986). The Treasury Department has important responsibilities for the United States financial markets, and its views on that subject carry weight, but the CFTC's views are the ones that are entitled to *Chevron* deference. See *Smiley*, 116 S. Ct. at 1733 ("We accord deference to agencies under *Chevron*, not because they drafted the provisions in question, * * * but rather because of a presumption that Congress, when it left an ambiguity in a statute meant for implementation by an agency, understood that the ambiguity would be resolved, first and foremost, by the agency."); see also *Martin* v. *Occupational Safety & Health Review Comm'n*, 499 U.S. 144, 153 (1991).

This case, however, is not one that requires the Court to invoke *Chevron* deference principles. As this Court explained in *Chevron*, "[i]f the intent of Congress is clear, that is the end of the matter, for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress." 467 U.S. at 842-843. In this instance, the Court can ascertain through "traditional tools of statutory construction" that "Congress had an intention on the precise question at issue." *Id.* at 843 n.9. Hence, "that intention is the law and must be given effect."

Ibid. See, *e.g.*, *Estate of Cowart*, 505 U.S. at 477 (finding that the meaning of a statute is clear and hence there is no need to "resolve the difficult issues regarding deference which would be lurking in other circumstances").

As we explained in our brief in opposition to the petition for a writ of certiorari, the Court's resolution of the issue presented here will not fully resolve other legal issues involving the Treasury Amendment, including the significance of the board of trade proviso, which is not currently at issue in this case. See Br. in Opp. 10-12. The Treasury Department and the CFTC are currently conducting discussions aimed at arriving at a consensus on what the scope of the CFTC's regulation with respect to commodities named in the Treasury Amendment should be. Those discussions can take into account the institutional concerns of petitioners' amici, including their perception of the need for an exemption for interbank or other foreign-currency options transactions. As we have explained above (see pages 9-11, *supra*), the CFTC has broad authority under 7 U.S.C. 6(c) and 6c(b) to fashion exemptions for transactions in options involving foreign currency or other commodities from provisions of the CEA. The question presented here, however, is purely one of statutory construction. The court of appeals correctly ruled that the Treasury Amendment does not exempt foreign currency options from CEA regulation, and that the CFTC therefore has authority to bring this enforcement action.

CONCLUSION

The judgment of the court of appeals should be affirmed.

Respectfully submitted.

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AUGUST 1996

APPENDIX A

STATUTORY PROVISIONS

Sections 2, 5, and 6c of Title 7 of the United States Code provide as follows:

§ 2. Accounts, agreements, and transactions subject to jurisdiction of Commodity Futures Trading Commission; relation to jurisdiction of Securities and Exchange Commission and Federal and State courts; excepted transactions

(i) The Commission shall have exclusive jurisdiction, except to the extent otherwise provided in section 2a of this title, with respect to accounts, agreements (including any transaction which is of the character of, or is commonly known to the trade as, an "option", "privilege", "indemnity", "bid", "offer", "put", "call", "advance guaranty", or "decline guaranty"), and transactions involving contracts of sale of a commodity for future delivery, traded or executed on a contract market designated pursuant to section 7 of this title or any other board of trade, exchange, or market, and transactions subject to regulation by the Commission pursuant to section 23 of this title. Except as hereinabove provided, nothing contained in this section shall (I) supersede or limit the jurisdiction at any time conferred on the Securities and Exchange Commission or other regulatory authorities under the laws of the United States or of any State, or (II) restrict the Securities and Exchange Commission and such other authorities

from carrying out their duties and responsibilities in accordance with such laws. Nothing in this section shall supersede or limit the jurisdiction conferred on courts of the United States or any State. (ii) Nothing in this chapter shall be deemed to govern or in any way be applicable to transactions in foreign currency, security warrants, security rights, resales of installment loan contracts, repurchase options, government securities, or mortgages and mortgage purchase commitments, unless such transactions involve the sale thereof for future delivery conducted on a board of trade.

* * * *

§ 5. Legislative findings

Transactions in commodities involving the sale thereof for future delivery as commonly conducted on boards of trade and known as "futures" are affected with a national public interest. Such futures transactions are carired on in large volume by the public generally and by persons engaged in the business of buying and selling commodities and the products and byproducts thereof in interstate commerce. The prices involved in such transactions are generally quoted and disseminated throughout the United States and in foreign countries as a basis for determining the prices to the producer and the consumer of commodities and the products and byproducts thereof and to facilitate the movements thereof in interstate commerce. Such transactions are utilized by shippers, dealers, millers, and others engaged in handling com-

modities and the products and byproducts thereof in interstate commerce as a means of hedging themselves against possible loss through fluctuations in price. The transactions and prices of commodities on such boards of trade are susceptible to excessive speculation and can be manipulated, controlled, cornered or squeezed, to the detriment of the producer or the consumer and the persons handling commodities and the products and byproducts thereof in interstate commerce, rendering regulation imperative for the protection of such commerce and the national public interest therein. Furthermore, transactions which are of the character of, or are commonly known to the trade as, "options" are or may be utilized by commercial and other entities for risk shifting and other purposes. Options transactions are in interstate commerce or affect such commerce and the national economy, rendering regulation of such transactions imperative for the protection of such commerce and the national public interest.

* * * *

§ 6c. Prohibited transactions

(a) Meretricious transactions

It shall be unlawful for any person to offer to enter into, enter into, or confirm the execution of, any transaction involving any commodity, which is or may be used for (1) hedging any transaction in interstate commerce in such commodity or the products or byproducts thereof, or (2) determining the price basis of any such transaction in interstate commerce in such com-

modity, or (3) delivering any such commodity sold, shipped, or received in interstate commerce for the fulfillment thereof—

(A) if such transaction is, of the character of, or is commonly known to the trade as, a "wash sale," "cross trade," or "accommodation trade," or is a fictitious sale; or

(B) if such transaction is used to cause any price to be reported, registered, or recorded which is not a true and bona fide price.

Nothing in this section shall be construed to prevent the exchange of futures in connection with cash commodity transactions or of futures for cash commodities, or of transfer trades or office trades if made in accordance with board of trade rules applying to such transactions and such rules shall have been approved by the Commission.

(b) Regulated option trading

No person shall offer to enter into, enter into or confirm the execution of, any transaction involving any commodity regulated under this chapter which is of the character of, or is commonly known to the trade as, an "option", "privilege", "indemnity", "bid", "offer", "put", "call", "advance guaranty", or "decline guaranty", contrary to any rule, regulation, or order of the Commission prohibiting any such transaction or allowing any such transaction under such terms and conditions as the Commission shall prescribe. Any such order, rule, or regulation may be made only after notice and opportunity for hearing, and the Commission may set different terms and conditions for different markets.

(c) Regulations for elimination of pilot status of commodity option transactions; terms and conditions of options trading

Not later than 90 days after November 10, 1986, the Commission shall issue regulations—

(1) to eliminate the pilot status of its program for commodity option transactions involving the trading of options on contract markets, including any numerical restrictions on the number of commodities or option contracts for which a contract market may be designated; and

(2) otherwise to continue to permit the trading of such commodity options under such terms and conditions that the Commission from time to time may prescribe.

(d) Dealer options exempt from subsections (b) and (c) prohibitions; requirements

Notwithstanding the provisions of subsection (c) of this section—

(1) any person domiciled in the United States who on May 1, 1978, was in the business of granting an option on a physical commodity, other than a commodity specifically set forth in section 2 of this title prior to October 23, 1974, and was in the business of buying, selling, producing, or otherwise using that commodity, may continue to

grant or issue options on that commodity in accordance with Commission regulations in effect on August 17, 1978, until thirty days after the effective date of regulations issued by the Commission under clause (2) of this subsection: *Provided,* That if such person files an application for registration under the regulations issued under clause (2) of this subsection within thirty days after the effective date of such regulations, that person may continue to grant or issue options pending a final determination by the Commission on the application; and

(2) the Commission shall issue regulations that permit grantors and futures commission merchants to offer to enter into, enter into, or confirm the execution of, any commodity option transaction on a physical commodity subject to the provisions of subsection (b) of this section, other than a commodity specifically set forth in section 2 of this title prior to October 23, 1974, if—

(A) the grantor is a person domiciled in the United States who—

(i) is in the business of buying, selling, producing, or otherwise using the underlying commodity;

(ii) at all times has a net worth of at least $5,000,000 certified annually by an independent public accountant using generally accepted accounting principles;

(iii) notifies the Commission and every futures commission merchant offering the grantor's option if the grantor knows or has reason to believe that the grantor's net worth has fallen below $5,000,000;

(iv) segregates daily, exclusively for the benefit of purchasers, money, exempted securities (within the meaning of section 78c(a)(12) of title 15), commercial paper, bankers' acceptances, commercial bills, or unencumbered warehouse receipts, equal to an amount by which the value of each transaction exceeds the amount received or to be received by the grantor for such transaction;

(v) provides an identification number for each transaction; and

(vi) provides confirmation of all orders for such transactions executed, including the execution price and a transaction identification number;

(B) the futures commission merchant is a person who—

(i) has evidence that the grantor meets the requirements specified in subclause (A) of this clause;

(ii) treats and deals with all money, securities, or property received from its customers as payment of the purchase price in connection with such transactions, as belonging to such customers until

the expiration of the term of the option, or, if the customer exercises the option, until all rights of the customer under the commodity option transaction have been fulfilled;

(iii) records each transaction in its customer's name by the transaction identification number provided by the grantor;

(iv) provides a disclosure statement to its customers, under regulations of the Commission, that discloses, among other things, all costs, including any markups or commissions involved in such transaction; and

(C) the grantor and futures commission merchant comply with any additional uniform and reasonable terms and conditions the Commission may prescribe, including registration with the Commission.

The Commission may permit persons not domiciled in the United States to grant options under this subsection, other than options on a commodity specifically set forth in section 2 of this title prior to October 23, 1974, under such additional rules, regulations, and orders as the Commission may adopt to provide protection to purchasers that are substantially the equivalent to those applicable to grantors domiciled in the United States. The Commission may terminate the right of any person to grant, offer, or sell options under this subsection only after a hearing, including a finding that the continuation of such right is contrary to the public interest: *Provided*, That pending the completion of such termination proceedings, the Commission may suspend the right to grant, offer, or sell options of any person whose activities in the Commission's judgment present a substantial risk to the public interest.

(e) Rules and regulations

The Commission may adopt rules and regulations, after public notice and opportunity for a hearing on the record, prohibiting the granting, issuance, or sale of options permitted under subsection (d) of this section if the Commission determines that such options are contrary to the public interest.

(f) Nonapplicability to foreign currency options

Nothing in this chapter shall be deemed to govern or in any way be applicable to any transaction in an option on foreign currency traded on a national securities exchange.

(g) Oral orders

The Commission shall adopt rules requiring that a contemporaneous written record be made, as practicable, of all orders for execution on the floor or subject to the rules of each contract market placed by a member of the contract market who is present on the floor at the time such order is placed.

APPENDIX B

Letter from the Acting General Counsel of the Treasury proposing the "Treasury Amendment," reproduced in Senate Report No. 1131, 93d Cong., 2d Sess. 49-51 (1974):

THE GENERAL COUNSEL OF THE TREASURY.
Washington, D.C., July 30, 1974.

Hon. HERMAN E. TALMADGE,
Chairman, Committee on Agriculture and Forestry,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: The attenton of the Department has been directed to H.R. 13113, S. 2485, S. 2578 and S. 2837, bills to regulate futures trading in agricultural and other commodities, which are currently pending before your Committee.

Each of these bills would establish a Federal regulatory agency with sweeping authority to regulate futures trading in virtually any commodity, good, article, right or interest. This authority would extend to the regulation of futures trading in foreign currencies. Moreover, H.R. 13113 and S. 2578 would amend the Commodity Exchange Act, 7 U.S.C. Sec. 1, *et seq.*, to subject futures trading in foreign currencies to the regulatory requirements of that Act.

The Department believes the bills contain an ambiguity that should be clarified. The provisions of the bills do not clearly indicate that the new regulatory agency's authority would be limited to the regulation of futures trading on organized exchanges, and would not extend to futures trading in foreign currencies off organized exchanges. We do not believe

that either the House of Representatives or your Committe intends the proposed legislation to subject the foreign currency futures trading of banks or other institutions, other than on an organized exchange, to the new regulatory regime.

The Department feels strongly that foreign currency futures trading, other than on organized exchanges, should not be regulated by the new agency. Virtually all futures trading in foreign currencies in the United States is carried out through an informal network of banks and dealers. This dealer market, which consists primarily of the large banks, has proved highly efficient in serving the needs of international business in hedging the risks that stem from foreign exchange rate movements. The participants in this market are sophisticated and informed institutions, unlike the participants on *organized* exchanges, which, in some cases, include individuals and small traders who may need to be protected by some form of governmental regulation.

Where the need for regulation of transactions on other than organized exchanges does exist, this should be done through strengthening existing regulatory responsibilities now lodged in the Comptroller of the Currency and the Federal Reserve. These agencies are currently taking action to achieve closer supervision of the trading risks involved in these activities. The Commodity Futures Trading Commission would clearly not have the expertise to regulate a complex banking function and would confuse an already highly regulated business sector. Moreover, in this context, new regulatory limitations and restrictions could have an adverse impact on the usefulness and efficiency of foreign exchange markets for traders and investors.

Section 201 of H.R. 13113 currently contains broad language that would appear to authorize the new agency to regulate bank foreign currency departments. Section 201 provides that the new Commodity Futures Trading Commission would have "exclusive jurisdiction of transactions dealing in, resulting in, or relating to contracts of sale of a commodity for future delivery, traded or executed on a domestic board of trade, contract market or on any other board of trade, exchange, or market." The bill would amend the Commodity Exchange Act, 7 U.S.C. 1 *et seq.*, to broaden the definition of commodity to include all goods, articles, services, rights and interests "in which contracts for future delivery are presently or in the future dealt in." (Section 201). Since this definition would encompass foreign currencies, it seems clear that the language of the bill would give the Commission authority to regulate futures trading in foreign currencies by banks. Moreover, the language "or any other board of trade, exchange, or market" is sufficiently broad to authorize the Commission to regulate trading in foreign currencies by banks in the over-the-counter market.

S. 2837, S. 2485, and S.2578 are also, in our view, unclear whether they would authorize the regulation of futures trading in foreign currencies by banks. For example, section 301 of S. 2837 provides that it "is unlawful for any person to buy or sell, or offer to buy or sell, any futures contract except on an exchange registered under section 201." Section 201(a) provides that it is unlawful for an exchange to permit futures contracts to be traded on it unless the exchange is registered with the Futures Exchange Commission. A futures contract is defined as "an agree-

ment to buy or sell for delivery at a future time any specified quantities of goods, services, or other tangible or intangible things." (Section 102(3)). This definition is broad enough to include futures contracts in foreign currencies. The term "exchange" is defined broadly to mean "any place where futures contracts are traded." (Section 102(10)).

Accordingly, S. 2837 could be construed to prohibit banks from engaging in futures trading in foreign currencies unless they registered as an exchange with the new Futures Exchange Commission and became subject to its regulation. We believe that this is a serious defect in the proposed legislation that would, if enacted, impair the usefulness and efficiency of our foreign exchange markets.

In addition, the Department is concerned that the language of the bills is broad enough to subject to regulation by the proposed futures trading regulatory agency a wide variety of transactions involving financial instruments, such as puts and calls, warrants, rights, resale of installment loan contracts, repurchase options in Government securities, Federal National Mortgage Association mortgage purchase commitments, futures trading in mortgages contemplated by Federal Home Loan Mortgage Corporation, etc. We feel that regulation of these transactions which generally are between large, sophisticated institutional participants, is unnecessary, and could be harmful. For this reason, we do not believe it is contemplated that the bills should regulate transactions in financial instruments of that nature.

In view of the foregoing, we strongly urge the Committee to amend the proposed legislation to make clear that its provisions would not be applicable to

futures trading in foreign currencies or other financial transactions of the nature described above other than on organized exchanges. This could be accomplished by inserting a new section in an appropriate place reading as follows:

"Sec. —. Nothing in this Act shall be deemed to govern or in any way be applicable to transactions in foreign currency, security warrants, security rights, resales of installment loan contracts, re-purchase options, government securities, mortgages and mortgage purchase commitments, or in puts and calls for securities, unless such transactions involve the sale thereof for future delivery conducted on a board of trade."

The Department has been advised by the Office of Management and Budget that there is no objection from the standpoint of the Administration's program to the submission of this report to your Committee.

Sincerely yours,

DONALD L. E. RITGER,
Acting General Counsel.

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